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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 259

HOLIDAY LODGE, INC.,
Petitioner,

vs.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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To The Honorable Chief Justice And Associated Justices Of The Supreme Court Of The United States:

Petitioner, Holiday Lodge, Inc., prays that a Writ of Certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit, reversing the order of the District Court in a Chapter XI proceeding, which order had temporarily enjoined respondent from foreclosing its mortgage on petitioner's property.

OPINION.

The opinion of the Court below, and adhered to upon rehearing, is set forth in the Appendix of this petition for the convenience of this Court, and is reported in 300 F. 2d 546.

BASIS OF JURISDICTION.

Jurisdiction is invoked under Section 716 of Title 11 Section 47 (c) of Title 11 and Section 1251 (1) of Title 28 of the United States Code. The opinion of the Circuit Court of Appeals was filed on March 13, 1962; a petition for rehearing was duly filed March 28, 1962 and an order denying the petition for rehearing was entered on April 19, 1962. This petition is filed within ninety days thereafter.

QUESTIONS PRESENTED FOR REVIEW.

1. Does the Bankruptcy Court in arrangement proceedings have the jurisdiction to temporarily restrain a mortgagee from foreclosing its mortgage on real estate leased to the Debtor, where the lease is subordinate to the mortage lien?

2. Does a District Court abuse its discretion in refusing to vacate an order restraining a mortgagee from foreclosing its mortgage on real estate owned by the Debtor, where, after six months of extensive hearings during which period the mortgagee vigorously contested the Court's jurisdiction, the District Court found that it had jurisdiction over the mortgagee, that the subject property was worth substantially more than the mortgage indebtedness, and that to permit an immediate foreclosure sale would cause irreparable injury to the junior interests?

3. Did not the Court of Appeals err in holding that the District Court had abused its discretion in not requiring the Debtor to file a plan of arrangement, where the record is abundantly clear that the District Court, on review, *reversed* the Referee *because* of his refusal, among other things, to permit the Debtor to file a plan; and was it not patent error for the Court of Appeals to find that

Debtor's plan, *which was not even before it on appeal*, was based on "hopes, purely speculative?"

4. Was not the intent of Congress, as expressed by Chapter XI legislation, to avert the evils of liquidation by affording to a Debtor an orderly process for rehabilitation, thwarted and nullified by the action of the Court of Appeals in concerning itself only with the right of the mortgagee to foreclose and by ignoring, as immaterial and irrelevant, the positive findings of a District Judge that the subject property is worth substantially more than the amount of the mortgage indebtedness, particularly where the mortgagee has not challenged the findings of the District Court, that it is more than amply secured and that an immediate foreclosure sale would totally wipe out the debtor and its unsecured creditors, and result in its unjust enrichment?

STATUTES INVOLVED.

Section 311 of Chapter XI of the Bankruptcy Act, 11 U.S.C. § 711, provides:

> "Where not inconsistent with the provisions of this Chapter, the Court in which the petition is filed, shall, for the purposes of this Chapter, have exclusive jurisdiction of the debtor and his property wherever located."

Section 314 of Chapter XI of the Bankruptcy Act, 11 U.S.C. Section 714 provides:

> "The Court may, in addition to the relief provided by Section 11 of this Act and elsewhere under this title, enjoin or stay until final decree the commencement or continuation or suits other than suits to enforce liens upon the property of the debtor, and may,

upon notice and for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the property of a debtor."

STATEMENT OF THE CASE.

To avoid controversy we accept the following statement from the opinion of the United States Circuit Court of Appeals, Seventh Circuit which, with two basic omissions and one obvious error of fact, substantially sets up the facts as follows:

"Prior to November 15, 1958, Morris S. Bromberg and his wife, owners of vacant real estate, organized 4800 Marine Drive, Inc., an Illinois corporation, of which they and his brother were the sole shareholders, and conveyed the real estate to that corporation. Thereupon, the Association made a first mortgage loan to the corporation for $750,000 amortized over a 15-year period, evidenced by a note and a mortgage covering said real estate, payable in monthly installments, $6431 of principal and interest, beginning January 30, 1960, and the corporation agreed to deposit 1/12th of the estimated annual real estate taxes with the Association. The mortgagor also assigned to the Association all leases and the rents, issues and profits.

At the same time Bromberg organized Holiday Lodge, Inc., an Illinois corporation, debtor herein, which took a lease of the premises from 4800 Marine Drive, Inc. for 25 years from May 1, 1959, upon rentals which varied according to an agreed schedule. The lease granted an option to debtor to purchase the leased premises at certain times and for certain amounts.

A motel was constructed thereon and commenced operation in December, 1959. Financial problems arose in meeting the mortgage payments. The debtor's operations did not produce sufficient income to pay the

rent, taxes and required mortgage payments, amounting in all to $10,300 a month. Partial payments were made on the mortgage but only sufficient to make the payments through June, 1960. Bromberg discussed with the Association these financial problems. By deed recorded October 13, 1960, the mortgagor quitclaimed its interest in the premises to Central National Bank in Chicago, as trustee. On December 2, 1960, the Association advised the mortgagor that it had elected to accelerate the maturity of its note and declared the entire balance of $750,676.73 due. The board of directors of the Association on December 13, 1960 authorized foreclosure of the mortgage. Meanwhile, creditors of the debtor met to discuss its problems, which the Association's representatives attended. However, in January, 1961 the Association informed Bromberg that unless brought to a current status by the end of January, its mortgage would be foreclosed.

On January 30, 1961 an involuntary petition was filed against the debtor and there was a general order of reference.

On February 1, 1961, petitioning creditors filed a motion to adjudicate debtor a bankrupt and to restrain the Association from taking any legal action or commencing any proceeding to foreclose the trust deed executed by the "alleged bankrupt and secured on its realty" located at 4800 Marine Drive, Chicago, Illinois until further order of the court. Such a restraining order was entered on February 3, 1961.

On the same day, the debtor filed a petition for an arrangement under Chapter XI; and the debtor was given authority to operate its business.

On February 15, 1961, the Association filed a petition to vacate the restraining order and for leave to join the debtor as defendant in its proposed foreclosure.

Numerous hearings followed before a referee until April 12, 1961, when no plan or arrangement having

been filed by the debtor, the referee entered a rule to show cause why the proceedings should not be dismissed.

On April 14, 1961 debtor's petition to make an arrangement was dismissed, an order of adjudication was entered and a receiver appointed. On May 8, 1961 the referee vacated the restraining order of February 8, 1961. This was followed by the filing of a foreclosure suit by the Association in the Superior Court of Cook County, Illinois.

On its review of the order of May 8, 1961, the court on July 18, 1961 commenced a *de novo* hearing on the petition to vacate the restraining order of February 3, 1961. On July 31, 1961, the court made findings of fact and conclusions of law, entered an order reversing the referee's orders, except the one appointing a receiver, and referred the case to another referee, and specifically continued the restraining order against the Association and denied its motion to vacate said order. This appeal followed.

On debtor's petition the district court, on July 31, 1961, reviewed these proceedings before the referee and the receiver was continued in possession, where he still continues to operate the business of debtor."

One controlling fact was omitted from the opinion: The petitioner, as lessee, in building the motel, used not only the proceeds of the mortgage but added $400,000 of its own funds towards the costs of construction. (A. 93-94).

Another omission: While the order appealed from was entered on July 31, 1961, respondent failed to perfect its appeal promptly. On the contrary, it sought and obtained various extensions of time so that Appellant's (Respondent's) appendix and brief was not filed until December 7, 1961, nearly five and one-half months after entry of the order. The materiality of this fact will appear later.

A patent error in the decision of the Appeals Court was its conclusion that:

> ". . . no plan of arrangement or any proposed plan had been submitted when the order appealed from was entered." (Opinion p. 6 in attached Appendix)

That this finding is clearly contrary to the record before the Appeals Court is shown by the following excerpts from the respondent's Appendix:

(A.40)

> "It is therefore ordered that the *motion of Debtor* to file instanter *a plan of arangement* be and the same is hereby denied." (emphasis supplied)

(From Referee's order)

(A. 79)

> "The *proposed plan* that *was* presented was not a feasible plan . . . but he was wrong in not giving an opportunity . . . for filing of a plan." (emphasis supplied)

(From the District Judge's finding of facts)

(A. 95-96)

> "This matter coming on to be heard . . . on . . .
>
> "The motion of the Debtor to file instanter a plan of arrangement and the order of the Referee denying the Debtor leave to file instanter a plan of arrangement;
>
> • • •
>
> "DOTH FIND:
>
> (1) That the order of the Referee denying the Debtor leave to file a Plan of arrangement was in error."
> (from the District Judge's order of July 31, 1962)

REASONS FOR GRANTING WRIT.

I.

THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, IN ITS INTERPRETATION OF 11 USCA §714, UPON A QUESTION OF FEDERAL LAW, IS IN DIRECT CONFLICT WITH THE DECISION OF THE SECOND CIRCUIT COURT OF APPEALS IN THE CASE OF LOCKHARDT v. GARDEN CITY BANK, 2 Cir. (1940) 116 F. 2d 658, 660, ON THE SAME ISSUE.

The decision of the Court below, in the instant case, after stating that one of the issues in the case was:

> "Does the Court in a Chapter XI proceeding have the power to restrain a mortgagee from foreclosing a mortgage on real estate which is the subject of a lease to the debtor, which lease is subordinate to the mortgage."

held that the District Court did not have jurisdiction saying:

> "It . . . (the debtor) . . . took its lease subject to that mortgage lien. That being so, the District Court, as a Bankruptcy Court, had no jurisdiction to restrain a State Court proceeding to enforce the Association's lien on the property to the extent that it was superior to any interest belonging to the debtor in that property.
>
> "*Thus both* literally, according to the language of § 714, and as a matter of equity, the Court *did not have jurisdiction* under this section to *grant* or *continue* the *restraining order*." (Italics supplied)

In the *Lockhardt* case (*supra*) the 2nd Circuit Court held contrariwise:

> "But the mortgagee argues that the jurisdiction of the Court . . . under Chapter XI unlike the situation in ordinary bankruptcy or in Chapter X proceedings do *not extend to property on which a lien* is held, because an arrangement may not alter the rights of secured creditors . . .
>
> "This however is not inconsistent with the exclusive *jurisdiction* of the Court *over mortgaged property*. Under ordinary bankruptcy, too, the rights of secured creditors may be not curtailed . . . and the object of the Court's control is not necessarily the curtailment of rights, but the supervision of their enforcement in order to protect the interests of other creditors, interests which would be substantial if the property proved to be more than sufficient to satisfy the secured debts, *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U.S. 734, 738." (Italics supplied)

That a conflict exists between the decision in the instant case and the *Lockhardt* case is inferentially conceded by Mr. Justice Duffy, in his separate opinion, described as a "concurring" opinion, but which appears on its face to be a "dissent". In his "concurring" (dissenting?) opinion Justice Duffy said (Opinion p. 8, Appendix hereto attached)

> "I agree with the result reached. . .
>
> • • •
>
> "I do *not* agree with the statement in the opinion that the District Court did not have jurisdiction to *grant* or *continue* the *restraining order* . . .
>
> "It now appears to be clear . . . that the Court has power, in a Chapter XI proceeding to exercise its injunctive and stay powers . . . against destructive or *unduly* damaging suits and foreclosures, *at least temporarily* and for good cause shown."

"The fact that Chapter XI proceedings cannot affect the securities of the first mortgage lien does not preclude the Bankruptcy Court from considering a plan and to restrain a threatened foreclosure while the Court may give consideration to that plan." (Italics supplied)

Justice Duffy quoted from Remington on Bankruptcy, Volume 9 (1955 Ed.), Section 314, at page 260. Page 260, note 3, refers to Section 3579, *ante;* that section at page 222, note 9, thereon states:

"See discussions in *Lockhardt* v. *Garden City Bank & Trust Co.*, 116 F. 2658."

II.

THE DECISION BELOW, COMPLETELY DISREGARDING THE SUBSTANTIAL RIGHTS OF THE DEBTOR, WHICH THE CHANDLER ACT SOUGHT TO SAFEGUARD, AND CONCERNING ITSELF ONLY WITH THE RIGHTS OF THE MORTGAGEE, WHICH THE DISTRICT COURT FOUND WERE AMPLY SECURED, IS A SUBSTANTIAL DEPARTURE FROM FUNDAMENTAL PRINCIPLES OF LAW, ENUNCIATED BY THIS COURT ON THE SUBJECT OF THE REMEDIAL AND PROGRESSIVE ACTS OF CONGRESS ON BANKRUPTCY.

In *Adair* v. *Bank of America*, 303 U.S. 350, 354, this Court held:

"Then the interests of the creditor *alone* were protected. Progressive liberalization of Bankruptcy and insolvency laws in an effort to avert the evils of liquidation have furnished an opportunity for composition in bankruptcy proceedings and later, for composition and extension of debts in relief proceedings for individual creditors, for reorganization of railroads and other corporations and public debtor proceedings" (Italics supplied)

See also:

In Equitable Office Building Corp., 96 L. Ed. 1387, 1390.

This was a memorandum decision in chambers, in which Mr. Justice Reed granted a stay order sought by the stockholders of the Debtor in a Chapter X proceeding, and in connection therewith, stated:

> "A court of reorganization guards with equal solicitude the *equity* of stockholders *and* the *priority* of creditors." (Italics supplied)

The lower Court in the instant case, by treating as irrelevant and immaterial, the findings of fact by the District Court that the property was worth substantially more than the amount of the mortgage indebtedness and that an immediate foreclosure sale would do irreparable injury to junior interests, failed to follow the ruling of this Court in:

Marine Properties v. *Trust Co.*, 317 U.S. 78, 87.

where this Court in a Chapter X proceedings held:

> "If there were a showing, for example, that the property was *worth more* than the amount of the mortgage indebtedness and it appeared that the excess would be lost to junior interests in the state proceedings, approval of the petition would be justified." (Italics supplied)

While the instant proceedings are under Chapter XI, where no approval for the filing of a petition for arrangement is required, what was said by this Court in *Marine* (*Supra*) assuredly must have even greater application to a Chapter XI proceeding.

It is to be observed that the findings of the District Court, in the instant case, both as to value and to the danger of irreparable injury to junior interests, were neither

challenged by the respondent nor disturbed by the Appeals Court in its opinion.

III.

THE COURT OF APPEALS BELOW FAILED TO RECOGNIZE AND APPLY THE BINDING AND CONTROLLING FORCE OF THE APPLICABLE DECISIONS OF THIS COURT TO THE FACTS IN THE CASE AT BAR.

We emphasize the fact that the said Appeals Court failed to apply the principles of law enunciated by this Court in the case of:

Continental Illinois Bank v. *Rock Island Railroad*, 294 U.S. 648, 677-678.

which coincidently arose out of this same Seventh Circuit, except that the current Appeals Court did not follow its previous decision, which was affirmed by the Supreme Court in *Continental*.

The decision of the Appeals Court in the case at bar is contrary to *Continental* in at least three important respects.

(1) In the instant case the lower court treated as "immaterial and irrelevant" the finding made by the District Court that:

> "... an immediate sale by the owner of the first mortgage would do *irreparable* injury to the creditors, to the owner of the equity and other creditors and it would bring unjust enrichment to the First Federal ..." (Emphasis supplied) (Opinion p. 4—attached Appendix)

In *Continental* (*supra*) this Court held that the mere fact that a foreclosure would "embarrass" a plan of reorganization, was sufficient to justify the District Court's order of restraint, stating at page 678:

"It is evident that the effect here wrought by the menace of impending sales of the collateral would seriously embarrass and probably prevent the formulation or consumation of a plan of reorganization."

(2) In the instant case the Court below held:

"... the natural effect of prolonged interference with a foreclosure proceeding ... amounts to a *freezing of assets*, while it is in effect, a condition not consistent with that degree of liquidity requisite in any financial organization engaged in the acceptance of funds of many members of the public. (Emphasis supplied) (Opinion p. 7 in attached Appendix)

By contrast this Court in *Continental* (*Supra*), answering an even stronger complaint by secured creditors that the collateral would decline in value said (page 678):

"It may be, as suggested, that during the period of restraint, the collateral will *decline* in value; but the same may be said in respect to an injunction against the sale of real estate upon foreclosure of a mortgage; and such an injunction may issue in an *ordinary* bankruptcy. *Straton* v. *New*, 283 U.S. 318, 321, and cases cited." (Emphasis supplied)

(3) In the instant case the Court below held that it was an abuse of discretion for the District court, to have refused to vacate the restraining order, 6 months after it was originally issued and that it was a further abuse of discretion on the part of the District Court not to have required Debtor during that time to file a plan of arrangement.

In *Continental*, this Court, confronted with a similar complaint by the appellant therein, enunciated the following proposition of law (pp. 684-685), which the current Court of Appeals for the Seventh Circuit was obliged to but failed to follow:

". . . without adequate excuse, the retention of the injunction for a long period which has intervened since it was granted, could hardly be justified. But the delay (1½ years) is due to the many doubts and uncertainties arising from the present litigation. Until they are finally resolved the consumation or preparation of any definite plan is plainly impracticable" (Parenthesis supplied)

In the case at bar the delay of six months was directly attributable to the action of the Appellants in vigorously contesting, at numerous hearings, the jurisdiction of the District Court. During this period the consummation or preparation of any definite plan was plainly impractical. Although the Appeals Court found that the District Court had erred in not requiring Debtor to submit a plan of reorganization, the record, as we have shown previously, demonstrates that Debtor, even though under the authority of *Continental* it was not obliged to, nevertheless *did* attempt to submit a plan within the six months' period and before the order appealed from was entered.

What was said by this Court in *Continental* was reiterated subsequently in *Equitable Office Building Corporation, supra,* 92 L. Ed. 1387, 1390 wherein Justice Reed stated:

"Delay in reorganization due to uncertainty of legal rights is regrettable but inevitable in such a situation as this. Net earnings of the property will accumulate for the prevailing parties."

In the case at bar net earnings of the subject property has accumulated for the prevailing parties. As of July 1, 1962, the Federal Court Receiver has on hand approximately $45,000.00 in net earnings over and above operating expenses.

IV.

THE COURT BELOW HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THE EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

1. The decision of the Court below in the instant case is not only contrary to the clearly expressed intention of the Congress in enacting remedial legislation, but its inevitable effect is to create confusion and embarrassment in the administration of bankruptcy law in matters where presumably the law was settled. The Seventh Circuit Court of Appeals in ruling that the District Court had abused its discretion in continuing the temporary restraining order, notwithstanding the District Court's well-considered and undisputed findings of fact, failed to follow the prevailing judicial criteria repeatedly enunciated by this Court. The leading case which establishes the standards for determining whether a District Court has abused its discretion in issuing a temporary injunction is:

Ohio Oil Co. v. *Conway*, 279 U.S. 813, 815,

where this Court stated:

> "Where the questions presented by an application for an interlocutory injunction are grave, and the injury to the moving party will be certain and *irreparable* if the application is denied and the final decree be in his favor, while if the injunction is granted the injury to the opposing party, even if the final decree be in his favor will be inconsiderable or may be adequately indemnified by a bond, the injunction usually will be granted. (citing cases) (Emphasis supplied)

(In the instant case the Court below apparently treated as irrelevant two findings of the District Court:

(a) That the injury would be irreparable, and

(b) That the mortgagee was amply secured.)

In *Alabama* v. *U.S.*, 279 U.S. 229, 231, this Court held:

> "It is well established doctrine that an application for an interlocutory injunction is addressed to the sound discretion of the Trial Court, and an order, either granting or denying such an injunction will not be disturbed by an Appellate Court unless the discretion was improvidently exercised (citing cases). The rule generally to be applied in the exercise of that discretion is stated in our recent decision in *Ohio Oil Co.* v. *Conway*, 279 U.S. 813, 815.
>
> "The duty of the Court therefore, upon an appeal from such order, at least generally, is not to decide the merits but simply to determine whether the discretion below was abused. See *United States* v. *Baltimore & Ohio Railroad Co.*, 225 U.S. 306, 325."

2. The decision of the Circuit Court of Appeals in the instant case, by failing to adhere to its *own rulings in previous cases*, will create confusion in the administration not only of Chapter XI but also of Chapters X, XII and XIII which contain provisions similar to 11 U.S.C.A. § 714.

In the early case of *In Re Sterba*, 74 Fed. (2) 413, 415, (7th C.A.) involving Section 74, which the Appeals Court in the instant case recognized as being the forerunner of Chapter XI (See opinion p. 5, Note 2, attached Appendix), the Court refused to disturb the order of the District Court restraining a mortgage foreclosure, where notwithstanding appellant's argument that Section 74:

> ". . . is inapplicable to a secured indebtedness which is owned solely by one owner who is unwilling to accept an extension proposal and whose secured claim is the sole encumbrance against one piece of property."

The Court stated:

> "This Court has held *In Re Fred E. Lindquist et al., Debtors*, 70 F. (2nd) 929, that the enactment of Sec-

tion 74 was a valid exercise of power by Congress. We see no reason for withdrawing from the position there taken. Again, *In Re Chicago, Rock Island & Pacific Railroad Co., Debtor*, 72 F. (2d) 443, this Court sustained the validity of similar legislation."

(The latter case was affirmed by the Supreme Court in *Continental* (*supra*), 294 U.S. 648)

"Nor can we find support in reason for a different conclusion because of its application to secured creditors. Assuming as we do that Federal legislation on the subject of bankruptcies is for the benefit and relief of creditors and debtors in cases where the debtors are unable to pay their debts, we see no reason for distinguishing between the right of a bankrupt to invoke the jurisdiction of the Court to administer estates, which are encumbered in part and instances where it is invoked to administer estates where the debts are all unsecured."

and at page 415-416 the Court continued:

"The secured creditor holding the $20,000.00 mortgage should not be permitted to withdraw the property thus liened from the control of the Court and the claims of the other creditors.

"For by so doing, an asset of value may be taken from the creditors, and likewise, the debtor's prospect of ultimately paying his debts in full, for which this Section 74 was enacted, might be greatly lessened."

This case was followed by *In Re Llewellin*, 83 F. 2d 588, 590, where the Seventh Circuit Court reaffirmed its judgment in *Sterba* and added that

"any plan must be fair to both parties. The mortgagee is entitled to equal consideration with the mortgagor."

V.

THE INSTANT DECISION OF THE COURT OF APPEALS WHICH HAS CONCERNED ITSELF ONLY WITH THE RIGHTS OF THE MORTGAGEE AND COMPLETELY DISREGARDED THE RIGHTS OF THE DEBTOR, THUS NULLIFIES AND DESTROYS THE INTENT AND PURPOSE OF THE CHANDLER AMENDMENT TO THE BANKRUPTCY ACT WHICH IS DESIGNED TO REHABILITATE AND NOT LIQUIDATE THE DEBTOR.

In the instant case it is clear from the record that the Appeals Court failed to apprehend the intent of Congress in its enactment of the progressive bankruptcy legislation which was designed primarily to rehabilitate the debtor, and to avert the evils of forced liquidation. In any event, the Appeals Court failed to follow the literal as well as the liberal interpretation of the legislation, as enunciated by this Court or, for that matter, its own previous pronouncements. Stripping the instant case down to essentials, the following facts clearly emerge:

1. Debtor filed a petition for Arrangement.
2. An order was entered by the Referee temporarily restraining an attempted foreclosure.
3. The mortgagee immediately announced that it would not cooperate with the Debtor in any plan of arrangement and challenged the authority of the court to restrain its attempted foreclosure.
4. The Referee, holding that it would be impossible for the Debtor to file a feasible plan of Arrangement without the cooperation of the mortgage, denied leave to the Debtor to file a plan or arrangement, dismissed the Chapter XI proceeding, ordered that the Debtor be adjudged a Bankrupt and vacated the restraining order.

5. Upon review, the District Judge found that the Referee erred in refusing to permit Debtor to file a plan of Arrangement and thereupon reinstated the Chapter XI proceeding, and gave leave to Debtor to file its plan.

6. The District Judge further, after determining that the Court had jurisdiction to temporarily restrain the mortgage foreclosure, refused to vacate the restraining order on the grounds that the property was worth at least $400,000.00 more than the amount of the mortgage indebtedness and that an immediate foreclosure sale would cause irreparable injury to the junior interests.

In view of these facts, it should be clear, that the Circuit Court of Appeals, below, erred in reversing the District Court on the grounds that it "abused its discretion" in

"not requiring debtor to file a definite Plan"

while it was involved in extensive hearings to determine whether or not it had jurisdiction over mortgagee.

The Appeals Court erred in departing from its own ruling as enunciated in *Chicago, Rock Island Pacific Railroad*, 72 F. 2d 443, 551. (Affirmed in *Continental* (*supra*)) where the former 7th Circuit Court said:

> "Surely we are justified in giving to the amendment Sec. 77 of the Bankruptcy Act a *liberal construction*, one that is consonant with the purposes of the remedial legislation. That which distinguishes this section from the old Act is the provision which calls for a plan of reorganization. It calls not for a sale of assets and the discharge of the debtor . . . but for a plan of reorganization *so that the debtor may live* and *the credi-*

> *tors receive more than is obtainable under a liquidation sale.* The consummation of a fair and equitable plan of reorganization is the goal of the legislation. How could a plan of reorganization be perfected unless the court restrained creditors and lienholders from proceeding in a manner which would defeat the consummation of the plan?" (Emphasis supplied)

So too in the instant case, once the District Court determined adversely to mortgagee, the challenge to its jurisdiction, it gave leave to debtor to file a plan. How could a plan of arrangement be promulgated and perfected, "unless the Court restrained creditors and lienholders from proceeding in a manner which would defeat the consummation of the plan." *Chicago, Rock Island (Supra)*

This Honorable Court, in affirming this decision (*Continental Illinois National Bank* v. *Chicago, Rock Island & Pacific Ry Co.*, 294 U.S. 648)—added on page 676, 677:

> "The injunction does not infringe Section 67. The substance of that provision is that bona fide liens shall not be affected by anything contained in the Bankruptcy Act. *The injunction here in no way* disturbs the *preferred rank of the* pledgees. *It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action.*" (Emphasis supplied)

We respectfully submit that the Circuit Court of Appeals for the Seventh Circuit properly evaluated and interpreted the intent and purpose of the remedial legislation enacted by the Congress when it rendered its decision in *Chicago, Rock Island and Pacific Ry. Co.* (affirmed by this Court), and that it departed from that decision when it rendered its decision in the instant case. The only concern expressed by the Appeals Court in the case at bar

was that the restraining order of the District Court amounting to a "freezing of assets" of Respondent, disregarding what had been said previously in *Continental* that even though, during the period of restraint, the assets of the bank might "decline in value", the Bankruptcy Court nevertheless could and should restrain the contemplated foreclosure sale if the effect wrought by the menace of the impending sale would prevent the formation or consummation of a plan.

It is apparent here that a foreclosure in the state court would wipe out the interests of the debtor and its creditors, and that they would lose the benefits, advantages and protection that Congress sought to grant in its enactment of Chapter XI.

The principal error committed by the lower court, it would appear, was to ignore the admonition of this court in:

S.E.C. v. *U. S. Realty & Invest. Co.*, 310 U.S. 434, 457.

> ". . . . a bankruptcy court cannot because of its own notions of equitable principles, refuse to award the relief which Congress has accorded the bankrupt . . .
>
> "Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."

Moreover, the lower Court disregarded its own recent decision of:

Evansville Television, Inc., C.A. 7th, (1961) 286 F. 2d 65, where in a Chapter X proceeding it said:

> "The district court was justified in approving the petition and awaiting the facts as they arise from a plan of reorganization (not then before the Court)" (parenthesis supplied)

In Chapter X, the statute (11 U.S.C. § 546-3) provides "that a petition shall be deemed not to be filed in good faith if—it is unreasonable to expect that a plan of reorganization can be effected." Yet, the same Circuit Court, which approved the action of the District Court in finding that the petition was filed in good faith, in *Evansville* (*supra*), where the Debtor was:

> "insolvent . . . with but a temporary permit to pursue the activities upon which its financial existence depended. *And it was unable to obtain needed financing.*" (Emphasis supplied)

in the instant Chapter XI case, where there is no provision similar to Sec. 546-3, as aforesaid, and where the District Court found there was an equity of at least $450,000.00, the Appeals Court nevertheless held that the District Court "abused its discretion" in not requiring the Debtor to file a plan during the time it was considering a challenge of its jurisdiction, after which it granted leave to debtor to file a plan and refused to vacate the order restraining the foreclosure sale, which would wipe out that substantial equity and prevent the attainment of the consumation of a plan which was the very purpose of Chapter XI. As a matter of fact, in the instant case the lower Court went even further by holding that the plan which "was not filed" was based on "hopes, wholly speculative".

The Court below also failed to comprehend the spirit and the liberal intent of the Congressional Amendments to the bankruptcy act, as interpreted by this court in *Continental* (*supra*), where this Court said:

> "It may be that in an ordinary bankruptcy proceeding, the issue of an injunction in the circum-

stances here presented would not be sustained. As to that it is not necessary to express an opinion. But a proceeding under Sec. 77 (11 U.S.C.A. § 205) is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization if a satisfatory plan to that end can be devised and to prevent the attainment of that object is to defeat the very end the accomplishment of which is the sole aim of the section and thereby to render its provisions futile."

In conclusion, we respectfully submit that because:

1. There is a patent conflict between the instant decision and decisions of other jurisdictions;

2. The court below has decided a federal question that is in conflict with applicable decisions of this Court;

3. The undisputed findings of the District Court is that the property is valued in excess of $400,000.00 over and above the mortgage indebtedness thus insuring that the security of the mortgagee will not be impaired during the period of restraint.

4. The issue here is of considerable practical importance in the administration of the Bankruptcy Act, particularly as it applies to the remedial amendments to the Act, and thus presents a situation which calls for the exercise of this Court's power of supervision.

For the reasons cited in this Petition we respectfully pray that the Court grant its Writ of Certiorari.

Respectfully submitted,

CARROL A. TELLER
MORRIS S. BROMBERG
Attorneys for Petitioner

APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 13536 SEPTEMBER TERM, 1961, JANUARY SESSION, 1962

In the Matter of
HOLIDAY LODGE, INC.,
Debtor,
FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CHICAGO, a United States corporation,
Appellant,
v.
HOLIDAY LODGE, INC., an Illinois corporation, NATHAN J. LEVIN, et al., Petitioning Creditors and GERALD GRACE, Receiver,
Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

March 13, 1962

Before DUFFY, SCHNACKENBERG and KILEY, *Circuit Judges.*

SCHNACKENBERG, *Circuit Judge.* First Federal Savings and Loan Association of Chicago,[1] a United States corporation, appealed from an order of the district court entered July 31, 1961, *continuing* a restraining order entered against it on February 3, 1961, in a Chapter XI proceeding, 11 U.S.C.A., § 714, initiated by an involuntary petition in bankruptcy filed by the unsecured creditors of

[1] Hereinafter called the Association.

Holiday Lodge, Inc., an Illinois corporation, debtor, on January 30, 1961.

There does not seem to be any controversy about the facts which we now state.

Prior to November 15, 1958, Morris S. Bromberg and his wife, owners of vacant real estate, organized 4800 Marine Drive, Inc., an Illinois corporation, of which they and his brother were the sole shareholders, and conveyed the real estate to that corporation. Thereupon the Association made a first mortgage loan to the corporation for $750,000 amortized over a 15-year period, evidenced by a note and a mortgage covering said real estate, payable in monthly installments, $6431 of principal and interest, beginning January 30, 1960, and the corporation agreed to deposit 1/12 of the estimated annual real estate taxes with the Association. The mortgagor also assigned to the Association all leases and the rents, issues and profits.

At the same time Bromberg organized Holiday Lodge, Inc., an Illinois corporation, debtor herein, which took a lease of the premises from 4800 Marine Drive Inc. for 25 years from May 1, 1959, upon rentals which varied according to an agreed schedule. The lease provided that it was subordinated to the lien of any mortgage upon the premises and all advances made on the security thereof. The lease granted an option to debtor to purchase the leased premises at certain times and for certain amounts.

A motel was constructed thereon and commenced operation in December, 1959. Financial problems arose in meeting the mortgage payments. The debtor's operations did not produce sufficient income to pay the rent, taxes and required mortgage payments, amounting in all to $10,300 a month. Partial payments were made on the mortgage but only sufficient to make the payments through June, 1960. Bromberg discussed with the Association these financial problems. By deed recorded October 13, 1960, the mortgagor quitclaimed its interest in the premises to Central National Bank in Chicago, as trustee. On December 2, 1960, the Association advised the mortgagor that it had

elected to accelerate the maturity of its note and declared the entire balance of $750,676.73 due. The board of directors of the Association on December 13, 1960 authorized foreclosure of the mortgage. Meanwhile, creditors of the debtor met to discuss its problems, when the Association's representatives attended. However, in January, 1961 the Association informed Bromberg that unless brought to a current status by the end of January, its mortgage would be foreclosed.

On January 30, 1961 an involuntary petition was filed against the debtor and there was a general order of reference

On February 1, 1961, petitioning creditors filed a motion to adjudicate debtor a bankrupt and to restrain the Association from taking any legal action or commencing any proceeding to foreclose the trust deed executed by the "alleged bankrupt and secured on its realty" located at 4800 Marine Drive, Chicago, Illinois until further order of the court. Such a restraining order was entered on February 3, 1961.

On the same day, the debtor filed a petition for an arrangement under Chapter XI, and the debtor was given authority to operate its business.

On February 15, 1961, the Association filed a petition to vacate the restraining order and for leave to join the debtor as a defendant in its proposed foreclosure.

Numerous hearings followed before a referee until April 12, 1961 when, no plan or arrangement having been filed by the debtor, the referee entered a rule to show cause why the proceedings should not be dismissed.

On April 14, 1961 debtor's petition to make an arrangement was dismissed, an order of adjudication was entered and a receiver appointed. On May 8, 1961 the referee vacated the restraining order of February 3, 1961. This was followed by the filing of a foreclosure suit by the Association in the Superior Court of Cook County, Illinois.

On its review of the order of May 8, 1961, the court on July 18, 1961 commenced a *de novo* hearing on the petition to vacate the restraining order of February 3, 1961. On July 31, 1961, the court made findings of fact and conclusions of law, entered an order reversing the referee's orders, except the one appointing a receiver, and referred the case to another referee, and specifically continued the restraining order against the Association and denied its motion to vacate said order. This appeal followed.

On debtor's petition the district court, on July 31, 1961, reviewed these proceedings before the referee and the receiver was continued in possession, where he still continues to operate the business of debtor.

Debtor in its brief in this court cites as significant the district court's statement at the hearing on July 31, 1961:

> "I would find that . . . an immediate sale by the owner of the first mortgage would do irreparable injury to the creditors, to the owner of the equity and other creditors, and it would bring unjust enrichment to the First Federal, . . ."

1. The Association states in these words two issues as it sees them:

> Does the court in a Chapter XI proceeding have the power to restrain a mortgagee from foreclosing a mortgage on real estate which is the subject of a lease to the debtor, which lease is subordinate to the mortgage?
>
> Is the refusal to vacate an order restraining foreclosure of such a mortgage an abuse of discretion when such refusal is made six months after entry of the restraining order during which period the debtor lessee has paid no rent, its business has not earned sufficient to pay current rent, and mortgagee has been paid nothing on its mortgage?

In response, debtor states:

> In view of the fact that appellant has never (to this very day), attempted to refute the positive find-

ings of the Court that Debtor's property, exclusive of the fee, has a present valuation in excess of $450,000.00 over and above the balance due appellant, and that appellant is more than amply secured, the Court was warranted in refusing to vacate the order restraining appellant from foreclosing its mortgage since such foreclosure would have destroyed any hope of Debtor's rehabilitation within the contemplation of Chapter XI and would have resulted in an *unjust enrichment* to appellant at the expense of Debtor and its unsecured creditors.

Debtor relies on Chapter XI, 11 U.S.C.A., §714, which provides:

> The court may * * * for cause shown, enjoin or stay until final decree any act or the commencement or continuation of any proceeding to enforce any lien upon the property of a debtor. * * *

The Association relies upon *Brunn* v. *Wichser*, 3 Cir., 75 F.2d 25, and *In re Patten Paper Co.*, 7 Cir., 86 F.2d 761, as recognizing that, in a situation such as the one in the case at bar, the holder of a first mortgage should not be restrained from enforcing the lien of that mortgage against the property therein pledged as security, the first mortgagee having no claim against the second mortgagees and none against their property, that it should not be restrained from enforcing the lien of its first mortgage against the property therein pledged as security unless there is something else in the section[2] which stays that right.

Finding none, the court concluded in *Brunn* that the extension which the district court had granted the debtors for payment of their debts did not include the first mortgage.

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[2] Paragraph (h) of § 74 (11 U.S.C.A. § 202 (h)) which provides:
"The terms of an extension proposal may extend the time of payment of either or both unsecured debts and secured debts the security for which is in the actual or constructive possession of the debtor or of the custodian or receiver. * * *"
This section is a forerunner of the section relied on by debtor in this case.

In *Patten Paper Co.*, we said, at 765:

> "The District Court had no jurisdiction to restrain state court proceedings to enforce a lien on property that did not belong to the debtor. In re Bekkedal & Sons, Inc. (C.C.A.) 81 F.(2d) 337; In re Prudence Co. (C.C.A.) 82 F.(2d) 755; In re Adolph Gobel, Inc. (C.C.A.) 80 F.(2d) 849."

The applicability of these decisions to the case at bar is emphasized by the circumstances that the first mortgage here constitutes a lien on the property in question superior to debtor's leasehold interest and, to the extent of that lien, the debtor had no interest in the real estate. It took its lease subject to that mortgage lien. That being so, the district court, as a bankruptcy court, had no jurisdiction to restrain a state court proceeding to enforce the Association's lien on the property to the extent that it was superior to any interest belonging to the debtor in that property.

Thus, both literally, according to the language of § 714, and as a matter of equity, the court did not have jurisdiction under this section to grant or continue the restraining order.

The distinction which we make is well-stated in *Texas & N.O.R. Co.* v. *Phillips*, 5 Cir., 211 F.2d 419, 420-421, where a trustee in bankruptcy brought a proceeding against a railroad company for specific performance of an option to purchase real property described in a lease for ten years given by the railroad to the bankrupt. The railroad company moved to dismiss the petition for lack of jurisdiction, the referee denied the motion, and the district court affirmed.

The Court of Appeals agreed with the railroad company that the bankruptcy court did not have jurisdiction over the railroad's reversionary interest in the leased premises, recognizing that that interest in property was held adversely to the bankrupt estate. It held that although the trustee in bankruptcy had possession of the tangible property described in the lease, it did not have possession

of the railroad's reversionary interest, and the trustee was not disputing the lessor's title by seeking to acquire it. This was the reversionary interest of the lessor which arose by operation of the law when the leasehold was carved out of the fee simple title. Such reversion, not being owned by the bankrupt, is in legal contemplation not in possession of the bankruptcy court and it has no jurisdiction thereof.

2. Quite aside from the question of jurisdiction of the district court which we have discussed, the Association contends that the refusal of that court to vacate the restraining order after it had been in effect six months shows an abuse of that court's discretion.

While at one stage of the proceedings the district court seemed to recognize that the debtor had an obligation to submit a plan, because the court so told its lawyer, yet no plan of arrangement or any proposed plan had been submitted when the order appealed from was entered. Under the shelter of the restraining order, counsel for the debtor has continued to express hopes, wholly speculative, which significantly depend upon the continued restraint of the Association from foreclosing on its first mortgage which has legal priority to debtor's lease. Such hopes of debtor, in any event, do not constitute a plan. Even in a case where a plan had been submitted, *In re Murel Holding Corporation*, 2 Cir., 75 F.2d 941, 942, the court speaking thereof said:

> "* * * its effect is wholly speculative, based upon the expectations of those who have everything to gain and nothing to lose. * * * It does not seem to us that this setting authorized any stay; it should appear that the plan proposed has better hope of success; full details may not be necessary, but there must be some reasonable assurance that a suitable substitute will be offered. No doubt less will be required to hold up the suit for a short time until the debtor shall have a chance to prepare; much depends upon how long he has had already, and upon how much more he demands. But a stay should never be the automatic

result of the petition itself, and we cannot see that there was here anything else of substance."

During the protracted proceeding in the district court, before the referee and before the court itself, including a *de novo* hearing, the effect of the court's restraining order was to prevent the Association from resorting to the right of foreclosure to which it was entitled under the law of Illinois. This procedure strongly suggests the applicability of the language of Circuit Judge Murrah, in *Chaffee County Fluorspar Corp.* v. *Athan*, 10 Cir., 169 F.2d 448, 450, that the only asset of the debtor hangs by the thread of the stay order.

3. We are not unaware of the natural effect of prolonged interference with a foreclosure proceeding brought by a savings association, such as appellant in this case. It amounts to a freezing of assets, while it is in effect, a condition which is not consistent with that degree of liquidity requisite in any financial organization engaged in the acceptance of investment of the funds of many members of the public.

We hold that under all the circumstances the district court abused its discretion in continuing the restraining order in effect.

For the reasons herein stated, the order of July 31, 1961 continuing the restraining order entered on February 3, 1961, and refusing to vacate that order, is reversed.

ORDER REVERSED.

DUFFY, *Circuit Judge*, concurring.

I agree with the result reached and concur insofar as the decision rests on the ground that the District Court abused its discretion in continuing the restraining order in effect, under the circumstances of this case.

I do not agree with the statement in the opinion that the District Court did not have jurisdiction to *grant* or continue the restraining order (emphasis supplied), if

that means a District Court has no jurisdiction to restrain even temporarily a foreclosure when proceedings under Chapter XI have been instituted.

My understanding of the law is well stated in *Remington on Bankruptcy,* Volume 9 (1955 Ed.) Sec. 3614, at page 260: "Arrangements under Chapter XI cannot affect the rights of secured creditors . . . But it now appears to be clear . . . that the court has power in a Chapter XI proceeding to exercise its injunctive and stay powers . . . against destructive or unduly damaging suits and foreclosures, at least temporarily and for good cause shown."

The fact that Chapter XI proceedings cannot affect the securities of the first mortgage lien does not preclude the Bankruptcy Court from considering a plan and to restrain a threatened foreclosure, while the Court may give consideration to that plan.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Tuesday March 13, 1962

Before

Hon. F. RYAN DUFFY, *Circuit Judge*

Hon. ELMER J. SCHNACKENBERG, *Circuit Judge*

Hon. ROGER J. KILEY, *Circuit Judge*

In the Matter of Holiday Lodge, Inc., Debtor

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CHICAGO, a United States Corporation
Appellant,

No. 13536 vs.

HOLIDAY LODGE, INC., an Illinois corporation, Nathan J. Levin, et al., Petitioning Creditors and Gerald Grace, Receiver,
Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the order of the said District Court of July 31, 1961 continuing the restraining order entered on February 3, 1961 and refusing to vacate that order, be, and the same is hereby, REVERSED, with costs, in accordance with the opinion of this Court Filed this day.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago 10, Illinois

Thursday, April 19, 1962

Before

Hon. John S. Hastings, Chief Judge
Hon. F. Ryan Duffy, Circuit Judge
Hon. Elmer J. Schnackenberg, Circuit Judge
Hon. Win G. Knoch, Circuit Judge
Hon. Latham Castle, Circuit Judge
Hon. Roger J. Kiley, Circuit Judge
Hon. Luther M. Swygert, Circuit Judge

In the Matter of Holiday Lodge, Inc.,
Debtor.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CHICAGO,
Appellant,
vs.
HOLIDAY LODGE, INC., et al.,
Appellees.

No. 13536

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

IT IS ORDERED BY THE COURT that the petition for rehearing *en banc* filed by appellee-debtor in this cause be, and the same is hereby, DENIED.

LIBRARY
SUPREME COURT, U. S.

FILED
AUG 13 1962
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 259

HOLIDAY LODGE, INC.,

Petitioner,

vs.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CHICAGO,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

EDWARD ROTHBART,
One N. La Salle Street,
Chicago 2, Illinois,
Counsel for Respondent.

THE DUNTHORP-WARREN PRINTING COMPANY, CHICAGO

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 259.

HOLIDAY LODGE, INC.,

Petitioner,

vs.

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF CHICAGO.

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

OPINION.

The Opinion of the Circuit Court of Appeals for the Seventh Circuit is reported at 300 F. 2d 516 and is set forth in the Appendix to the Petition.

JURISDICTION.

The jurisdictional requisites are not adequately set forth in the Petition. None of the sections of the United States Code cited in the petition furnishes a basis of jurisdiction. It may be that Petitioner's reference to Section 1251(1) of Title 28 of the United States Code is an error and that Petitioner meant to invoke the jurisdiction of the Court under 28 U. S. C. 1254(1).

QUESTIONS PRESENTED FOR REVIEW.

1. Does the Court, in a proceeding under Chapter XI of the Bankruptcy Act, 11 U. S. C. Sec. 301-339, have the power to restrain a mortgagee from foreclosing a mortgage on real estate which is the subject of a lease to the Debtor, which lease is subordinate to the mortgage?

2. Is the refusal to vacate an order restraining foreclosure of such a mortgage an abuse of discretion when such refusal is made six months after entry of the restraining order, during which period the Debtor has paid no rent, the business has not earned sufficient to pay current rents, and the mortgagee has been paid nothing on its mortgage?

STATUTES INVOLVED.

The pertinent provision of the Bankruptcy Act—i.e., Sec. 314, 11 U. S. C. Sec. 714—is set forth at Pages 3-4 of the Petition.

STATEMENT OF THE CASE.

Petitioner's statement of the case, to the extent that it quotes the Opinion of the Court below at Pages 4-6 of the Petition, is satisfactory.

The so-called "controlling fact," the "omission" and the "patent error," referred to at Pages 6-7 of the Petition, are not accepted by the Respondent.

ARGUMENT.

I.

THE DECISION IS CLEARLY CORRECT.

The issue in the present case is a narrow one and the Petitioner by argument cannot convert it into one warranting review by this Honorable Court on Certiorari. Certiorari jurisdiction was not conferred upon the Court merely to give the defeated party another hearing. *Magnum Import Co. v. De Spoturno Coty*, 262 U. S. 159, 163. The Court below correctly found that the lien of the Respondent's mortgage was not on the property of the Petitioner and that, to the extent of that lien, the Petitioner has no interest in the real estate. This was a correct conclusion and the Petitioner, in his Petition for Certiorari, does not say otherwise—does not contend that Respondent's lien is on the property of the Petitioner. Thus, the Court below correctly concluded that "* * * literally, according to the language of Sec. 714, * * * the court did not have jurisdiction under this section to grant or continue the restraining order."

The Court below, of course, did not rest its decision on the sole ground of the literal language of Section 714 but also concluded that under all the circumstances the District Court abused its discretion in continuing the restraining order in effect. While the restraining order had been in effect for six months, Respondent's mortgagor was paying nothing on the mortgage indebtedness (App. 90) and the Petitioner was occupying the mortgaged premises rent-free; and, further, the Petitioner had conceded that any Plan of Arrangement it might propose would require

the continued restraint of the Respondent. Thus, the only asset of the Petitioner hung by the thread of the stay order, and the reasoning of *Chaffee County Fluorspar Corp.* v. *Athan*, 169 F. 2d 448, 450, was applicable.

On the facts presented by this Record, the decision of the Court of Appeals was manifestly correct.

II.

THERE IS NO CONFLICT OF DECISION.

Petitioner asserts that the decision in the instant case is in conflict with the decision of the Second Circuit Court of Appeals in the case of *Lockhart* v. *Garden City Bank*, 116 F. 2d 658. Such is not the case. The *Lockhart* case involved a chattel mortgage on the automobile and trucks of the Debtor. In the instant case, the real estate mortgage held by the Respondent is not on the property of the Debtor—it is on the real estate of the Debtor's lessor. The Petitioner (Debtor) is a mere tenant. The issue in the *Lockhart* case was whether or not the chattel mortgage given by the Debtor was void as against a Trustee in Bankruptcy. In the *Lockhart* case, there was no restraining order and the comments of the Court there, to which the Petitioner refers at Page 9 of its Petition, are not only dictum but clearly show that the Court there was discussing the effect of Section 714 as it related to mortgaged property of the Debtor. The Court was not discussing the question of jurisdiction by virtue of Section 714 over property which is the mortgaged property of the Debtor's lessor, as is the property in the instant case.

III.

THE DECISION OF THE COURT BELOW DOES NOT CALL FOR THE EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

Petitioner asserts that the Court below disregarded the rights of the Debtor. No one can disagree with the proposition that the rights of the Debtor are to be safeguarded in a Bankruptcy proceeding, but Petitioner has cited no case which suggests that in a Chapter XI proceeding one who is not a creditor of the Debtor may be indefinitely restrained from proceeding against such creditor's real estate security, which real estate is not property of the Debtor. Moreover, the effect of the restraining order was to permit the Petitioner to remain in possession of the mortgaged premises rent-free notwithstanding the obligation of the Debtor to pay the mortgage requirements and real estate taxes as part of the rent under Debtor's lease.

The remarks of the Court, quoted by Petitioner at Page 11 of its Brief, from *Marine Harbor Properties, Inc. v. Mfrs. Trust Co.*, 317 U. S. 78, 86, were obviously not concerned with a Chapter XI proceeding but with a Chapter X proceeding. The considerations to which the Court referred would be relevant if the instant case were a Chapter X proceeding and if the mortgage held by the Respondent were on the property of the Debtor. The contrary, of course, is true and Petitioner has referred to no authority approving the proposition that in a Chapter XI proceeding one who is not a creditor of the Debtor may be restrained indefinitely and as a part of the Plan of Arrangement from attempting to foreclose on its lien, which lien is not on the property of the Debtor. It is, of course, possible that creditors of Petitioner may suffer a loss, but that possibility should not deny Respondent, who is not a creditor of the Petitioner but is a secured

creditor of the Petitioner's lessor, from enforcing rights which its mortgage gives it and which its Board of Directors (App. 86) determined was the proper action to be taken by Respondent and which is consistent with its responsibility to its investors. What Respondent was concerned with, and brought to the attention of the Court below, was that there had been and would be further irreparable injury to it. Obviously, if a tenant of mortgaged premises can effectively restrain a mortgagee from proceeding against its mortgagor when the mortgage is in default, and the default in monthly payments continues month after month, the danger of irreparable injury is to the mortgagee—that is, this Respondent—and, if continued, the restraint permits the junior interests to speculate with the first mortgagee's security. This is particularly so when such tenant—the Debtor here—is attempting to make effective a Plan of Arrangement which calls, as the Court below found, for the continued restraint of such mortgagee —i.e., the Respondent.

There is no departure from fundamental law for there is no law—fundamental or otherwise—that permits a secured creditor of a Debtor's landlord to be restrained from proceeding against the landlord while the tenant attempts to effect a Plan of Arrangement—and particularly is there no such law which says that a failure to vacate such a restraining order after it has been in effect for six months may not be properly held to be an abuse of discretion.

The decisions to which Petitioner refers, under III at Page 12 of its Brief, are not applicable to the facts in the instant case for the reason, among others, that they do not relate to a Chapter XI proceeding. Obviously, Section 314 of the Bankruptcy Act—the Section which the Court construed in the instant case—was not involved in any of the cases the Petitioner there cites. Further, in *Continental Illinois Bank* v. *Rock Island R. R.*, 294 U. S. 648, cited at

Page 12 of the Petition, it was said that the injunctive power could be used only for a "reasonable time." Thus, under any analysis, there was still room for the Court below to decide that under all of the circumstances the injunctive power had been exercised for an unreasonable time.

Any delay of the case at bar is not attributable to Respondent. The Petitioner has been free since February 1961, and it is still free, to attempt to effect a Plan of Arrangement. But Petitioner's hopes for a Plan of Arrangement depended, and still depend on the Respondent being restrained *ad infinitum* from foreclosing on its mortgage.

Petitioner has seen fit to introduce, at the bottom of Page 14 of its Petition, a reference *dehors* the record that the Federal Court Receiver had, as of July 1, 1962, $45,000.00 in net earnings. This statement was injected in violation of the basic rule of appellate procedure which requires that the Court look only to the certified record in deciding questions presented. *Lawn v. United States*, 355 U. S. 339, 354. However, assuming that on July 1, 1962 the Federal Court Receiver did have $45,000.00, it is, nevertheless, true that this amount was realized during the period since January 30, 1961 when neither the Debtor nor the Receiver paid any rent for use and occupancy of the mortgaged premises or anything on account of the mortgage indebtedness (App. 89, 90), despite the fact that the lease between Petitioner and its lessor called for rent of $10,300.00 per month (App. 90). Thus, even if the Bankruptcy Receiver did have on hand, as of July 1, 1962, the sum of $45,000.00, such fact only serves to demonstrate that the cozy little operation of the Debtor's business was short well over $100,000.00, plus fees to the Receiver and his counsel and other costs of administration, to say nothing of failing to produce any sums to apply to the reduction of the mortgage delinquency which dates back to

June 1960 (App. 86). And the Petitioner having improperly opened the door to matters not in the Record compels us to point out that the mortgage indebtedness grew from $759,741.91, when the Bankruptcy proceeding began on January 30, 1961 (App. 87), to $856,224.76 on July 1, 1962. The mortgage held by Respondent has been delinquent since June 30, 1960 (App. 86). For more than twenty-five consecutive months not one dollar has been paid to Respondent on account of principal or interest owing on its mortgage.

The Court below has done what *Alabama* v. *United States*, 279 U. S. 229, cited by Plaintiff at Page 16 of its Petition, says is the duty of the Court upon an appeal from an order granting or denying an interlocutory injunction. The Court below has simply determined that in all events the discretion of the District Court was abused when it refused to vacate the six-month-old restraining order. And the Court of Appeals adhered to this view on rehearing *en banc* requested by Petitioner.

The argument of Petitioner, at Page 18, that the instant decision concerns itself only with the rights of the mortgagee is a gratuitous reflection upon the Court below. The rights of the Debtor-Petitioner have not been disregarded. The Debtor still has its lease and whatever rights that lease gives it. The Chandler Act has not been nullified. The Petitioner can still attempt to effect a Plan of Arrangement. The Court, however, did recognize that any Plan that the Debtor might propose was wholly speculative and required the continued restraint of Respondent. Petitioner does not here admit that any Plan it might propose would require the continued restraint of the Respondent but, in oral argument before the Court below, counsel for the Petitioner admitted that such was the case. In its Petition for rehearing, the Petitioner stated, at Page 18: "We have *never* asked, even *indirectly*, for a *judicial moratorium* on

any *future* payments . . . " and added " . . . and an orderly plan for prompt liquidation of past indebtedness is also provided for." It thus seems clear that Petitioner admits that its Plan asks for a judicial moratorium on the *delinquent* payments on Respondent's mortgage. The Petitioner has cited no authority which would permit approval of a Plan of Arrangement that calls for such a restraint or that would permit the Court to so restrain a secured creditor of the Petitioner's landlord.

The Court below did not, as Petitioner contends at Page 19 of its Petition, reverse the District Court on the ground that it abused its discretion in not requiring the Petitioner to file a definite Plan. The Court merely noted that one of the circumstances of the case was that no Plan, or any proposed Plan, had been submitted and further noted that "under the shelter of the restraining order counsel for the Debtor has continued to express hopes, wholly speculative, which significantly depend upon the continued restraint of the Association from foreclosing on its first mortgage, which has legal priority to Debtor's lease."

CONCLUSION.

It would appear that the Court of Appeals did what was right, proper and legal under the Record. For the foregoing reasons, it is respectfully submitted that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

EDWARD ROTHBART,
One N. La Salle Street,
Chicago 2, Illinois,
Counsel for Respondent.

JOHN P. DAVIS, CLERK

No. 259

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

HOLIDAY LODGE, INC.,
Petitioner,

vs.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Respondent.

PETITIONER'S REPLY TO RESPONDENT'S OPPOSITION BRIEF.

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The Scheffer Press, Inc.—ANdover 3-6850

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962.

No. 259

HOLIDAY LODGE, INC.,

Petitioner,

vs.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,

Respondent.

PETITIONER'S REPLY TO RESPONDENT'S OPPOSITION BRIEF.

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1. Jurisdiction of this Court is invoked under Section 1254 (1) of Title 28 of the United States Code and not under Section 1251 (1) as erroneously set forth in our original petition because of a typographical error.

2. Under Section 714 of Chapter XI of the Bankruptcy Act Congress has provided that:

> "The Court . . . may, upon notice And for good cause shown, enjoin or *stay* until final decree any act or the commencement or continuation of *any proceeding to enforce any lien* upon the *property* of the debtor." (Italics supplied)

3. The majority opinion of the 7th Circuit Court of Appeals, in its decision here sought to be reviewed, held:

> ". . . the first mortgage here constitutes a lien on the property in question superior to the debtor's leasehold and to the extent of that lien, the *debtor* had *no interest in the real estate.*" • • • "Thus, both literally, according to the language of § 714, and as a matter of equity, the *court* did *not* have *jurisdiction under* this *section* to grant or continue the restraining order." (Italics supplied)

4. The separate opinion of Justice Duffy, dissenting on this point, states the law, in our opinion, correctly:

> "I do not agree with the statement in the opinion that the District Court did not have jurisdiction to *grant* or continue the restraining order, if that means that the District Court has *no* jurisdiction to restrain even temporarily a foreclosure when proceedings under Chapter XI have been instituted."
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> • • •
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> ". . . it now appears to be clear . . . that the court has power in a Chapter XI proceedings to exercise its injunctive and stay powers . . . against destructive or unduly damaging suits and foreclosures, at least temporarily and for good cause shown.
>
> "The fact that Chapter XI proceedings cannot affect the security of the first mortgage lien does not preclude the Bankruptcy Court from considering a plan and to restrain a threatened foreclosure while the Court may give consideration to that plan."

5. Consequently there is herein involved a question of important public law namely: Whether a debtor who has spent in excess of $1,000,000 erecting a building on a mortgaged fee, on which he owns a long-term leasehold, is entitled to the remedial benefits of a Chapter XI proceedings, so that the mortgagee may be temporarily

enjoined from foreclosing during the pendency of a petition and plan for arrangement, particularly where the foreclosure proceedings threatens to wipe out not only the fee but the leasehold as well?

The 7th Circuit Court of Appeals' ruling that a debtor's leasehold interest represented "no interest in the real estate" is in direct conflict with the decision of this Court in *Erie Railroad* v. *Tompkins*, 304 U.S. 64, that on the question of substantive law, the Federal Courts are bound by the law of the *situs*.

The Illinois Supreme Court in *Pierce* v. *Pierce*, 4 Ill. 2d 497, affirming 351 Ill. A. 336, 342, held on the question, as to whether a leasehold may be the subject of partition, that a long term leasehold interest was not only an interest in real estate but is equivalent to *actual ownership*, stating:

> "A 'lease is a conveyance of an estate in real property (citing cases). The possession of the tenant is in law the possession of the landlord. (citing cases) The *title* to a *leasehold* estate which lessee has during the life of a lease is equivalent for all practical purposes to *actual* ownership' (citing cases)." (Italics supplied)

6. Even putting aside for a moment the undisputable fact that under Illinois law a long term leasehold is not only an "interest in real estate" but is "equivalent . . . to actual ownership" and that the Federal Courts are bound by the law of the *situs*, the effect of the decision of the Court below is to hold that it was the Congressional intent, that where a debtor has a 25 year leasehold on real estate, which is subject to a mortgage lien, he is to be deprived of the statutory benefits of a Chapter XI proceedings otherwise conferred by Congress on a debtor who owns an outright fee.

From an economic standpoint, is there any substantial difference between a long term leasehold and a fee, when measured by the remedial benefits Congress clearly intended to grant to distressed debtors?

Is a debtor owning a leasehold, who invests $1,000,000 to erect a building on a fee, subject to a mortgage, any different from a debtor who owns a fee subject to a mortgage? The economics and humane reasons which motivate all legislation providing for reorganization or arrangement proceedings for necessitous debtors, surely has equal applicability to both.

If the lower court's construction of the Congressional intent is to prevail, a large class of debtors will be unjustly and arbitrarily discriminated against and deprived, without logic or reason, of the protection Congress intended to afford under Chapter XI when it granted to bankruptcy courts its stay powers under Sec. 714.

On the economic level, this Court will take judicial notice that throughout the country each year, increasingly, countless millions of dollars are being invested in the construction of buildings on leasehold property and that, as in the case at bar, this new construction is being financed by mortgage money. Indeed, these sale and leaseback arrangements are proving so popular for sound economic reasons that in many instances, the new construction, upon which the healthy economy of our nation depends, would be seriously affected if the lower court's construction of Chapter XI that a leasehold is "*not* an interest in the real estate" were to remain unchallenged.

In its opinion the lower court held that since debtor:

> ". . . took its lease subject to that mortgage lien . . . the bankruptcy court had no jurisdiction to restrain the . . . *lien* on the *property* to the extent that it was *superior to any interest* belonging to the *debtor* in that property." (Appendix p. 6a)

Carried to its logical conclusion this language would nullify *all* remedial relief not only for one owning a long term leasehold but for the owner of a fee as well, because even an outright fee on mortgaged property is *subject* to the superior lien of a mortgage. Thus, if the *superiority* of a mortgage lien over on interest in real estate, be it leasehold or fee, is held to be the absolute criterion, bankruptcy courts would automatically be deprived of the power to enjoin, even temporarily, the enforcement of a mortgage which is a lien superior to the interest of a debtor.

It must be obvious, therefore, that the lower court erred in holding as a matter of law that a debtor owning and in possession of a long term leasehold does not have the required property interest, referred to in Sec. 714 of Chapter XI, so as to entitle it to remedial relief.

II.

1. Having determined, however erroneously, that the District Court had no jurisdiction and power to enjoin the threatened foreclosure, even temporarily, the Court of Appeals might have stopped right there. Instead it went on to state by way of dicta that the continuance of the injunction and the District Court's refusal to vacate the same after it had been in effect for six months "shows an abuse of that court's discretion." A careful reading of the opinion makes it quite obvious that the Circuit Court of Appeals concluded that the District Court abused its discretion by not requiring the debtor to submit and proceed with a plan of arrangement.

This conclusion is unwarranted for the record clearly discloses that a plan of arrangement *was* submitted by the debtor. Furthermore, during that "six months" period the Referee and then the Judge were so preoccupied with respondent's repeated challenges to its jurisdiction, that it could not intelligently consider any plan.

Surely, it would have been legally economically unrealistic to proceed with an involved and expensive proceeding to bring an arrangement to a final decree where the basic question of jurisdiction over the mortgagee, so vigorously contested, was not yet finally determined.

2. While the importance of speed and dispatch in arrangement proceedings cannot be negated, here the delay in effectuating any plan of arrangements, was occasioned by *respondent's* vehement objections to the Court's jurisdiction. After six months of contesting the right and power of the court, to proceed and exercise jurisdiction, Respondents now turn about and charge the District Court with an abuse of discretion for not requiring debtor to submit a plan.

No court is warranted in proceeding with a debtor's plan of arrangement until all questions of jurisdiction have been resolved. Respondent set up a road block by raising the question of jurisdiction and now attempts to shift the responsibility for the delay they themselves caused.

That this is the correct view is demonstrated by the holding of this Court in *Continental Illinois Bank* v. *Rock Island Railroad*, 294 U.S. 648, 684, 685, referred to in our petition at pages 13 and 14.

In *Continental* the petitioners, holders of collateral of the debtor, had been enjoined by the District Court for a period of 1½ years from enforcing their claims; petitioner contended (as Respondent here contended) that the collateral would decline in value during any further period of restraint. Answering this contention the Court held that while the District Judge could not disregard the claim of injurious consequences, this was a matter ad-

dressed "not to the power of the Court but its discretion a matter *not subject to interference of an appellate court unless such discretion is improvidently exercised.*" (Italics supplied)

As shown in our petition on page 14, the Court further held:

> "But the delay is due to the many doubts and uncertainties arising from the present litigation. Until they are finally resolved, the consummation or preparation of any definite plan is plainly impractical."

3. Under the authority of *Continental*, while debtor was not obliged to submit a plan, nevertheless as shown in our petition at page 7, (Respondent's A. 40, 79, 95, 96) the record makes it manifestly clear that, in the instant case, debtor did attempt to submit a plan within the six month period.

What was said by this court in *Continental* was reiterated subsequently in *Equitable Office Building Corporation*, 92 L.ed. 1387, 1390, as shown in our petition at p. 14, where Justice Reed ruled in a Chapter X case:

> "Delay in reorganization due to uncertainty of legal rights is regrettable but inevitable in such a situation as this."

4. While expeditious handling of reorganization procedures under the Chandler Act is essential, it is now clear that Congress did not intend to provide that realistic consideration of practicability be sacrificed on the altar of speed. In 1958, Congress amended Sec. 323 (28 U.S.C.A. § 723) by eliminating the mandatory requirement that a plan of arrangement accompany the petition for arrangement.

Sec. 323 was amended by Public Law 85-732, 85th Congress, 2nd Sess., approved August 24, 1958. In Senate Report No. 2094, the purpose of that amendment is explained as follows:

> "The language of section 323 of Chapter XI now makes it mandatory that a plan of arrangement be filed with the petition. The proposed legislation would make this permissive rather than mandatory and thus permit a plan of arrangement to be filed subsequently . . .
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> "In its favorable report on the proposed legislation, the committee on the Judiciary of the House of Representatives has commented as follows on the desirability of this change:
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> The present requirement that the plan of arrangement be filed along with the Chapter XI petition has been found to be unrealistic and has resulted in either pro forma compliance by the filing of a hastily dratfed plan, or the adoption by some judges of extra-legal practices permitting filing of the petition without an accompany (*sic*) plan. It takes time and careful study to work out a realistic appropriate plan for a debtor. When a petition must be filed speedily to hold off marshalls or sheriffs, pro forma compliance with the requirement is the inevitable result, and the proceedings are then often encumbered with a poorly drafted, unworkable, or inequitable plan. (This legislation) adopts a more flexible procedure by permitting the filing of a petition alone, allowing time for the careful drafting of an effective and fair plan of arrangements which can be filed later." (See Collier; Bankruptcy Act. Pamphlet Ed. 1960)

From this it follows that Congress intended that this provision (Sec. 323) be liberally construed, and that the Court be allowed great latitude.

CONCLUSION.

We most earnestly urge that this Court consider that the case at bar involves a legal question of great public interest, undetermined by this Court, which affects the vital rights of the holders of millions of dollars of leasehold property throughout the United States, namely, whether Section 714 of Chapter XI of the Bankruptcy Act can properly be construed to exclude from the scope of its protection, the holders of leasehold property, particularly where there is no apparent legal or economic reason to attribute to Congress any such intent or construction.

Another question of vital significance concerns the administration of the Bankruptcy Act as it applies to the Chandler Amendment, namely, whether a District Court abuses its discretion in not requiring a plan of reorganization to be filed and acted upon while a fundamental challenge to its power is still pending.

In the case at bar, the leasehold of the debtor, which has an undisputed value of $1,250,000 (Respondent's appendix p. 94) or approximately $450,000 over and above the mortgage indebtedness, (Respondent's appendix p. 93) provides the first lienholder with more than an ample cushion of security.

For the Court of Appeals to hold that such a valuable long term leasehold is not property within the purview of Sec. 714 so as to confer jurisdiction upon a Bankruptcy Court in a Chapter XI proceedings to temporarily enjoin a foreclosure by a mortgagee which would wipe out that leasehold, does violence to the spirit and intent of the remedial legislation which is clearly designed to rehabilitate and not liquidate the debtor.

Unless the relief prayed for in this petition is granted, not only will there be unjust enrichment to the mortgagee and total destruction of the leasehold, fee rights and the rights of unsecured creditors but the economic consequences to leasehold transactions throughout the nation will be incalculable and will result in confusion in the administration of the Bankruptcy Act.

Respectfully submitted,

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